

BEFORE THE
UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Market Dominant Product Prices
Inbound Market Dominant Multi-Service Agreements
with Foreign Postal Operators 1

Docket No. R2015-5

Hongkong Post–United States Postal Service
Bilateral Agreement (MC2010-35)
Negotiated Service Agreement

PUBLIC REPRESENTATIVE COMMENTS ON
POSTAL SERVICE NOTICE CONCERNING
TYPE 2 RATE ADJUSTMENT AND HONGKONG POST
NEGOTIATED SERVICE AGREEMENT

(September 14, 2015)

The Public Representative hereby provides comments pursuant to Order No. 2664.¹ In that Order, the Commission established the above referenced docket to receive comments from interested persons, including the undersigned Public Representative, on a Postal Service Notice of a Type 2 rate adjustment in conjunction with a new market dominant international negotiated service agreement (NSA).²

The Notice concerns the inbound portion of a bilateral agreement with Hongkong Post to be included within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 (Multi-Service Agreements) product. The inbound portion of the agreement with Hongkong Post (Hongkong Post 2015-2016 Agreement) establishes negotiated rates for inbound letterpost in the form of small packets with delivery scanning (a.k.a., ePackets). Notice at 3.

Included as Attachment 1 to the Notice is an application for non-public treatment of materials filed under seal. A public (redacted) version of the Hongkong Post 2015-

¹ Order No. 2664, Notice and Order Concerning Type 2 Rate Adjustment and Functionally Equivalent Agreement, August 14, 2015.

² United States Postal Service Notice of Type 2 Rate Adjustment, Notice of Filing Functionally Equivalent Agreement, August 13, 2015 (Notice).

2016 Agreement is provided in Attachment 2.³ The Postal Service also filed under seal a non-public (unredacted) version of the Hongkong Post 2015-2016 Agreement and a supporting financial model estimating the volume, revenue, costs and contribution of the Agreement. On August 27, 2015, the Postal Service filed notice of errata, which includes a revised financial model to replace the original model provided under seal.⁴

In Order No. 549, the Commission approved the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product, and included the Strategic Bilateral Agreement Between United States Postal Service and Koninklijke TNT Post BV and TNT Post PakketSERVICE Benelux BV (TNT Agreement) and the China Post Group—United States Postal Service Letter Post Bilateral Agreement (China Post 2010 Agreement) within the product.⁵ Subsequently, the Commission determined that bilateral agreements with the China Post Group, Hongkong Post, Singapore Post Limited, the Australian Postal Corporation, the Canada Post Corporation, Korea Post, and the Netherlands Royal PostNL BV should be included within the Multi-Service Agreements product.⁶

The Hongkong Post 2015-2016 Agreement is the successor to an existing bilateral agreement with Hongkong Post (Hongkong Post 2013-2014 Agreement), which expired June 30, 2015. *Id.* The Postal Service states that the proposed Effective Date for the Hongkong Post 2015-2016 Agreement is October 1, 2015. Notice at 2. The Hongkong Post 2015-2016 Agreement is to remain in effect until December 31, 2016, a period of 15 months, unless terminated sooner. *Id.*, Attachment 2 at 7 (Article 22).

³ The Public Representative observes that the Postal Service's Notice did not include a copy of the Governors' Decision establishing prices and classifications for the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators product. Nor does the Postal Service's initial request to add this product to the market dominant product list include a Governors' Decision. See Request of United States Postal Service to Add Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators to the Market Dominant Product List, Notice of Type 2 Rate Adjustments, and Notice of Filing Two Functionally Equivalent Agreements (Under Seal), Docket Nos. MC2010-35, R2010-5, and R2010-6, August 13, 2010.

⁴ Notice of United States Postal Service of Filing Errata Concerning Notice of Type 2 Rate Adjustment and Notice of Filing Functionally Equivalent Agreement, August 27, 2015.

⁵ See Order No. 549, Order Adding Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 to the Market Dominant Product List and Approving Included Agreement, Docket Nos. MC2010-35, R2010-5 and R2010-6, September 30, 2010.

⁶ See <http://www.prc.gov/mail-classification-schedule>, (Draft) Mail Classification Schedule (MCS), June 4, 2015 (with revisions through: September 8, 2015), Section 1602.3.5, for a list of market dominant multi-service agreements currently in effect.

The Postal Service states that the negotiated prices in the Hongkong Post 2015-2016 Agreement will result in an “improvement over default rates established under the Universal Postal Union (UPU) Acts for inbound Letter Post items.” *Id.* at 1. The Postal Service also identifies three operational changes in the Hongkong Post 2015-2016 Agreement that it states “should enhance . . . the delivery services provided for inbound small packets with delivery scanning under the agreement.” *Id.* at 4.

Pursuant to Order No. 2148, the Postal Service identifies the China Post 2010 Agreement as the baseline agreement for functional equivalence comparisons.⁷ In this regard, the Postal Service maintains that the Hongkong Post 2015-2016 Agreement is “functionally equivalent to the China Post 2010 Agreement filed in Docket No. R2010-6.” *Id.* at 7. Therefore, the Postal Service requests that the Hongkong Post 2015-2016 Agreement be included within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 (MC2010-35) product. *Id.* at 8 and 10.

COMMENTS

The Public Representative has reviewed the Postal Service’s Notice, and the Hongkong Post 2015-2016 Agreement and supporting financial model filed under seal with the Notice. The Public Representative also reviewed the financial model for the China Post 2010 Agreement filed under seal in Docket No. R2010-6.

Based upon that review, the Public Representative concludes that the Hongkong Post 2015-2016 Agreement is functionally equivalent to the baseline China Post 2010 Agreement. Moreover, the Public Representative finds that the Hongkong Post 2015-2016 Agreement is likely to improve the net financial position of the Postal Service. However, the Postal Service provides no discussion, documentation or analysis to support its claim that the identified operational changes “should enhance” the operational performance of the Postal Service. As a result, the Public Representative cannot evaluate the expected impact, financial or otherwise, of such changes on the Postal Service’s operational performance during the term of the Agreement.

⁷ *Id.* at 7, *citing* Order No. 2148, Order Granting, In Part, Motion for Partial Reconsideration of Order No. 1864 and Modifying, In Part, Order No. 1864, Docket No. 2013-9, August 11, 2014.

Functional Equivalence. In support of its claim as to functional equivalence, the Postal Service asserts that the terms of the Hongkong Post 2015-2016 Agreement fit within the proposed Mail Classification Schedule (MCS) language for Inbound Market-Dominant Multi-Service Agreements with Foreign Postal Operators 1 product. *Id.* at 7. The Postal Service also states that the Hongkong Post 2015-2016 Agreement and the China Post 2010 Agreement are constructed from a similar template and contain many similar terms and conditions. *Id.* More importantly, the Postal Service states that the two agreements provide rates for the delivery of inbound small packets with delivery scanning tendered to the Postal Service from the territory of Hongkong Post. *Id.*

A review of the supporting financial models for the Hongkong Post 2015-2016 Agreement and the China Post 2010 Agreement reveal that the Hongkong Post 2015-2016 Agreement and the China Post 2010 Agreement share similar cost and market characteristics. In terms of market characteristics, both agreements establish negotiated rates for inbound ePackets tendered by both foreign postal operators.⁸ In terms of cost characteristics, both financial models develop unit costs for mail processing, delivery, domestic transportation, and all other domestic costs associated with inbound ePackets.⁹ The Public Representative therefore concludes that the Hongkong Post 2015-2016 Agreement is functionally equivalent to the China Post 2010 Agreement.

Statutory Criteria. Under 39 U.S.C. § 3622(c)(10), the criteria for Commission review are whether a Postal Service agreement (1) will be available on public and reasonable terms to similarly situated mailers, (2) either improves the net financial position of the Postal Service or enhances the performance of operational functions, and (3) will not cause unreasonable harm to the marketplace. With respect to criteria (1)

⁸ Compare the Service Descriptions and Stream codes in the China Post 2010 Agreement financial model, Excel file (Non-Public) China_MD_IB_2010.08.09, worksheet tab 12_Pieces-Wgt & TDues_Rates, columns B and C, and the Service Descriptions and Stream codes in the Hongkong Post 2015-2016 Agreement financial model, Excel file (Non-Public) Hong Kong_MD_IB_2015 - Revised - 2015.08.24, worksheet tab 12_Pieces-Wgt & TDues_Rates, columns B and C.

⁹ Compare the cost characteristics in the China Post 2010 Agreement financial model, Excel file (Non-Public) China_MD_IB_2010.08.09, worksheet tab 03_Dom_Tran_Inputs and 07_Stream_Unit_Cost_Inputs, and the cost characteristics in the Hongkong Post 2015-2016 Agreement financial model, Excel file (Non-Public) Hong Kong_MD_IB_2015 - Revised - 2015.08.24, worksheet tab 03_Dom_Tran_Inputs and 07_Stream_Unit_Cost_Inputs.

and (3), the Postal Service makes reasonable arguments that such criteria are not implicated by the Hongkong Post 2015-2016 Agreement. *Id.* at 2-5.

With respect to criterion (2), the Postal Service relies on a comparison of cost coverage at the negotiated rates and at UPU terminal dues rates to support its claim that the negotiated rates for inbound ePackets entered pursuant to the Hongkong Post 2015-2016 Agreement result in an improvement in cost coverage compared to the cost coverage at the terminal dues rates established by the UPU. However, the Public Representative notes that to make its comparison, the Postal Service's financial model uses the 2016 base terminal dues rates for inbound letterpost items exchanged between designated postal operators in the target system prior to 2010.¹⁰

The Postal Service's use of the 2016 base terminal dues rates is problematic. First, the 2016 base terminal dues rates applicable to designated postal operators in the target system prior to 2010 are not the default rates that would be paid by Hongkong Post for inbound letterpost tendered to the Postal Service in the absence of the Hongkong Post 2015-2016 Agreement. Hongkong Post would pay terminal dues applicable to countries that entered the target system as of 2010 and 2012. Second, the Postal Service used terminal dues rates applicable to 2016, even though the term of the Agreement is 15 months, which includes three months (October through December) in 2015. For these reasons, Postal Service use of the 2016 base terminal dues rates as the default rates results in the lowest possible cost coverage, which increases the likelihood that the cost coverage at the negotiated rates will be higher by comparison, thereby permitting a conclusion that the negotiated rates are an improvement over the default rates.

Instead, the default rates the Postal Service should use are the 2015 and 2016 provisional quality of service linked terminal dues rates applicable to inbound letterpost exchanged between designated operators in the target system as of 2010 and 2012, as

¹⁰ The Postal Service's financial model cites UPU International Bureau (IB) Circular 108, July 1, 2015. The terminal dues rates used by the Postal Service are found in Table 1.1., in the columns for items and kilograms headed: "Base TD rates in SDR for 2016." The United States became a target system designated operator prior to 2010.

well as operators in the target system prior to 2010.¹¹ The 2015 and 2016 provisional quality of service linked terminal dues rates are the default rates that will be paid by Hongkong Post for inbound letterpost in the absence of the Hongkong Post 2015-2016 Agreement during the 15 month period (October 2015 through December 2016) in which the Agreement would otherwise be in effect.

In the Postal Service's financial model, the Public Representative applied the 2015 and 2016 provisional quality of service linked terminal dues as the default rates to determine whether the cost coverage at the negotiated rates is greater than the cost coverage at the default terminal dues rates. Based upon this comparison, the cost coverage at the negotiated rates in Hongkong Post 2015-2016 Agreement is in an improvement compared to the cost coverage at the 2015 and 2016 provisional quality of service linked terminal dues rates. Thus, the Public Representative concludes that the negotiated rates in Hongkong Post 2015-2016 Agreement "improve the net financial position of the Postal Service." 39 U.S.C. § 3622(c)(10)(A)(i).

Nevertheless, the Public Representative respectfully requests that in future dockets considering the addition of inbound multi-service agreements, the Commission direct the Postal Service to develop its comparison of the cost coverage at the default rates using the UPU terminal dues rates that would otherwise be paid by the foreign postal operators during the term in which such future agreements would be in effect—assuming the absence of such agreements.

To satisfy criterion (2), the Postal Service also identifies, pursuant to 39 C.F.R. § 3010.42(g), three operational changes in the Hongkong Post 2015-2016 Agreement that it claims "should enhance" the performance of mail preparation, processing, transportation or other functions. Those changes are:¹²

- a process for collecting tracking events associated with small packets with delivery scanning sent from Hong Kong to the United States;
- the establishment of improved accounting and settlement processes; and

¹¹ For the 2015 default rates, refer to UPU IB Circular 108, July 1, 2015, Table 1.2, in the columns for items and kilograms headed: "Provisional QS linked TD rates in SDR for 2015."

¹² Notice at 3-4.

- sortation requirements.

Commission rule 3010.42(g) further requires “a discussion of the nature and expected impact of each enhancement.”

The Postal Service's claim that the identified operational changes “should enhance” the operational performance lacks substance. The Postal Service provides no analysis, or even discussion, of the nature and expected impact of each purported enhancement. As such, the Public Representative can only conclude that the identified operational changes are included as through-away items, intended to address in the most minimal fashion possible the Commission's rule, given the absence of any discussion concerning impact. Therefore, the identified operational changes cannot be used to satisfy the requirements of 39 U.S.C. § 3622(c)(10)(A)(ii).

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

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